

EXECUTIVE SUMMARY

DROP Cost Neutrality Study

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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A DROP cost neutrality study is fundamental in determining compliance with San Diego Municipal Code section 24.1401, in which it is stated that “DROP is intended to be cost neutral.” The DROP cost neutrality study, which will be presented to City Council on March 7, 2011, has been prepared by the firm of Buck Consultants.

After extensive discussions regarding the scope of the DROP cost neutrality study among the COO, the IBA and City labor unions, all parties agreed that the scope needed to be expanded to include an historical analysis, including an in-depth examination of changes in retirement behaviors due to DROP. Moreover, in addition to evaluating pension system costs, Buck comprehensively examined other DROP-related costs, including payroll, medical, and other fringe benefits. The resulting DROP cost neutrality analysis compares the present value of future benefits with and without DROP, and it is prospective in nature.

The result of the DROP cost neutrality study is that DROP is cost neutral based on the established 2% tolerance level; but it is not cost free. The results of Buck’s analysis show that the cost of the City benefits structure with DROP is 1.6% higher than the cost of the City benefits structure without DROP.

The largest cost differential between the City’s benefit structure with and without DROP is related to salaries. The salary differential is \$132.0 million of the \$148.7 million total differential – approximately 90% of the total. Buck has indicated that costs for employees who replace retiring employees are built into the salary analysis. Actual results will depend on actual hiring and promoting practices. It is possible that backfilling positions could negate some or a substantial portion of the cost differential related to salaries. It is important to note that this is a complex analysis, based on many assumptions and methods, and changes in those assumptions and methods could change the results of the analysis.

The IBA supports efforts that bring DROP toward the goal of being cost free. Further, it would be even better if DROP were to produce cost savings for the City, while providing an advantageous benefit for City employees.

The IBA recommends that the City consider obtaining a periodic DROP cost neutrality analysis – within two years if the City implements retiree healthcare reform, and possibly once every five years, thereafter.